

THE WHITE HOUSE
WASHINGTON

April 19, 1982

MEMORANDUM FOR THE PRESIDENT

FROM: THE CABINET COUNCIL ON ECONOMIC AFFAIRS

SUBJECT: Balanced Budget-Tax Limitation Constitutional Amendment

At the March 17 Cabinet meeting you requested the Cabinet Council on Economic Affairs to examine possible modifications in S.J. Res. 58, the balanced budget-tax limitation constitutional amendment, that could enhance the prospects for achieving its objectives.

The Cabinet Council has discussed several possible modifications in four principal areas:

1. Controlling outlays within a given fiscal year;
2. Exemptions for national emergencies;
3. The asymmetry between increasing taxes and permitting deficits; and
4. Additional implementation tools.

In developing the administration's position on S.J. Res. 58 we must consider both the substantive merits of possible modifications in its provisions and tactical considerations with respect to the legislative process and the views of its principal congressional sponsors.

There is no immediate action forcing event. The Senate Judiciary Committee reported the amendment out last July. But Senate floor consideration is not yet scheduled. No hearings by the House Judiciary Committee are scheduled before May 5. Moreover, since this issue is related to the current budget discussions with the Congress, there are good reasons for not publicly taking a position on S.J. Res. 58 beyond our current general support for a balanced budget amendment until after the budget discussions have concluded.

An issue paper with the Cabinet Council's recommendations on possible modifications in the four areas outlined above is attached.

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Donald T. Regan
Chairman Pro Tempore

Cabinet Council on Economic Affairs

Issue Paper

Balanced Budget - Tax Limitation Constitutional Amendment

I. Background

There are two principal objectives behind efforts to add various balanced budget and tax limitation amendments to the Constitution:

- o Limiting the rate of growth of federal spending to the growth rate of the economy; and
- o Offsetting those incentives in the political process which result in persistent budget deficits.

S.J. Res. 58, the balanced budget-tax limitation amendment with the most political support at this time, would help achieve both of these objectives. There are four potential difficulties with S.J. Res. 58, however, that merit consideration:

1. The amendment may not prove compatible with the business cycle "facts of life" which tend automatically to produce deficits during recessions and make it more difficult to control outlays within a given fiscal year;
2. The amendment provides no exemptions for periods of national emergency except that Congress may waive the amendment for any fiscal year in which a declaration of war is in effect.
3. The tax limitation and balanced budget rules in the amendment are asymmetrical, quite possibly resulting in a bias toward higher taxes rather than lower spending; and
4. The amendment lacks measures which prevent the Congress and future presidents from circumventing the objectives of its sponsors, either through spending programs which make overruns inevitable, or through budget devices outside the scope of any settled definition of "outlays."

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II. Controlling Outlays Within a Given Fiscal Year

The purpose of the balanced budget amendment is to impose discipline on the legislative and executive branches with regard to discretionary policy actions. Certain government outlays are not discretionary and can vary substantially depending on economic conditions which are difficult to forecast with precision. There are a number of options for modifying S.J. Res. 58 which would permit some flexibility under such circumstances while maintaining discipline with regard to discretionary actions.

Option 1: Permit an ordinary majority of both Houses to increase the outlay ceiling for interest payments on the national debt in excess of that estimated in the initial statement of outlays for a fiscal year.

Advantages:

- o Interest rate fluctuations are inherent in an economy with competitive financial markets, and will inevitably result in different debt interest costs for a fiscal year than originally estimated., Estimated debt interest costs for fiscal year 1982 have increased \$16 billion over the administration's initial estimates in March 1981.
- o Failing to provide flexibility for dealing with the effect of interest rate fluctuations on total budget outlays will complicate enforcing the amendment and could result in:
 - more frequent tax increases;
 - potentially disruptive spending cuts in the middle or near the end of the fiscal year; or
 - more frequent three-fifths votes to allow a budget deficit.

Disadvantages:

- o An exemption for higher than forecast interest payments might result in fewer years when revenues matched or exceeded outlays.
- o An interest rate exemption might result in congressional and executive branch budget officials persistently underestimating federal debt interest costs in order to

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achieve a balanced budget statement before the fiscal year begins.

Option 2: Provide modest flexibility in any single fiscal year by setting aside a small contingency fund of five percent of planned outlays.

Advantages:

- o A small contingency fund would simplify implementing the amendment. If the amendment were in force in fiscal year 1982, a five percent contingency fund would be about \$35 billion, more than sufficient to cover the \$31 billion increase in outlays due to unexpected economic conditions.
- o In effect, this alternative requires a small planned surplus. In the event that economic conditions are as good or better than expected, this could lead to an actual surplus.

Disadvantages

- o In the event that the contingency fund is not necessary to meet the outlay limit in a specific fiscal year, there may be an incentive to spend this fund on low priority activities.

Option 3: Leave the amendment unchanged, with a deficit in any year requiring a three-fifths vote of both Houses.

Advantages:

- o An administration proposal to reduce procedural constraints on deficit spending might be perceived as an attempt to "water down" the amendment.
- o An escape clause to allow deficit spending during a fiscal year would result in actually achieving a balanced budget less often.

Disadvantages:

- o S.J. Res. 58 requires a super-majority (60 percent) of the full membership of both Houses to agree in advance to a deficit.

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- o Failing to allow for business cycles and interest rate fluctuations in the amendment might result in recurring political crises, forcing the President and the Congress to choose in the face of a contracting economy between:
 - raising taxes;
 - radically reducing spending until a recovery raises receipts; or
 - achieving congressional super-majorities to validate recession deficits.

Recommendation: A majority of Cabinet Council members feel that greater flexibility is needed than is currently provided in the amendment for controlling outlays within a given fiscal year, specifically for outlays that do not result from discretionary policy actions.

Most favor permitting an ordinary majority of both houses to increase the outlay ceiling for interest payments on the national debt in excess of that estimated in the initial statement of outlays for a fiscal year. (Option 1)

Approve _____ Disapprove _____

III. Exemptions for National Emergencies

S.J. Res. 58 provides no exemptions for periods of national emergency, except that the Congress may waive the amendment for any fiscal year in which a declaration of war is in effect. The resolutions of at least 18 of the 31 states which have called for a constitutional convention to consider a balanced budget amendment include provisions for an exemption for national emergencies.

There are clearly a wide variety of events, not necessarily entailing a declaration of war, which representatives from all sides of the political spectrum would agree pose "threats to national security" or "national emergencies." These would include large and unexpected increases in military outlays, possibly involving mobilization and deployment of the armed forces, in preparation for a possible war. These might also include events requiring nonmilitary outlays, such as a series of massive bank failures, a major natural disaster, or a major oil supply interruption.

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In theory, spending for a national emergency could usually be accommodated through spending decreases elsewhere in the budget. If an emergency, such as a major armed conflict, is sufficiently costly, however, offsetting spending reductions in other budget categories is unlikely to prove feasible in practice. Also, if an emergency occurs late in the fiscal year, spending reductions in other categories, even if draconian on a percentage basis, are unlikely to yield the necessary absolute level of savings.

In deciding whether to broaden the range of emergencies which allow Congress to waive the amendment beyond those involving a declaration of war, the critical issue the administration must resolve is how wide or narrow a range of events should qualify for the exemption. The current exemption in the amendment for periods in which war is declared possesses an important attribute: it is clear when it does and does not apply. Broadening the exemption to apply to a wider range of events inevitably results in considerable ambiguity.

Short of a declaration of war, whether a particular event constitutes a threat to national security or a national emergency becomes highly subjective. While the legislative history accompanying the amendment could, if so drafted, provide some guidance regarding the magnitude of the event which was originally intended to qualify for the exemption, considerable imprecision would remain. The courts, based on historical practice, are unlikely to quarrel with a President's determination that an event qualifies for a national security or national emergency waiver, and so the exemption will unavoidably reduce the constraints on federal spending and deficits which the amendment is intended to establish. On the other hand, the amendment will not prove effective in the long-run if it does not provide sufficient flexibility to accommodate federal spending that is genuinely urgent and unanticipated.

There are three primary options in deciding whether to broaden the range of events resulting in a waiver of the balanced budget amendment beyond those involving a declaration of war.

Option 1: Provide an exemption for unforeseen events posing an imminent threat to the national security and involving the armed forces. The exemption would allow an increase in spending no greater than the costs incurred as a result of the specific emergency.

Advantages:

- o The United States has engaged in a number of armed conflicts not involving formal declarations of war, in-

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cluding those in Korea and Viet Nam. Declarations of war are infrequent, and requiring them to waive the balanced budget amendment could reduce the ability of the President and the Congress to respond to world events with the threat or actual use of armed force.

- o Although armed conflicts can begin and escalate in a variety of ways, a formal declaration of war is likely to follow rather than precede the mobilization and deployment of military forces. Restricting the President's ability to deploy armed forces might actually increase the chances of an international event leading to a war, since establishing a strong U.S. military presence might act as a deterrent.
- o Restricting the waiver to emergencies involving the armed forces will help ensure that it is applied only to genuine threats to the national security, and that it is not used as a routine means for circumventing the amendment's objectives.

Option 2: Broaden the range of events qualifying for the exemption to include unforeseen events posing an imminent threat to national security, but not necessarily involving the armed forces.

Advantages:

- o A wide variety of events can pose a threat to national security without necessarily requiring the use of U.S. armed forces. These can include domestic developments, such as a financial crisis or a natural disaster, or events overseas, such as an oil supply interruption.
- o A broad range of emergencies abroad can require a U.S. response, and higher budget outlays, without immediately involving the use or prospective use of the armed forces. Requiring a three-fifths vote of the full membership of both houses of Congress to increase spending in these events would seriously limit the President's ability to develop and implement viable foreign policies.

Option 3: Leave S.J. Res. 59 unchanged, with a waiver permitted only after a declaration of war.

Advantages:

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- o The amendment as currently written is not inflexible in that it allows spending increases by a three-fifths vote of the whole membership of both houses of Congress. Genuine "national emergencies" would usually result in Congressional waivers without the need for supplementary procedures.
- o It is impossible to devise clarifying language, either in the amendment itself or in the legislative history, which provides precise guidance as to what constitutes "an imminent threat to national security," either with or without the use of armed force. A broad national security exemption could reduce applicability of the amendment, and increase the ambiguity regarding its enforcement.
- o The purpose of the balanced budget amendment is to reduce federal spending and deficits. The broader the range of the amendment's exemption, the more difficult it is to achieve these goals.

Recommendation: A majority of Cabinet Council members feel that greater flexibility is needed than is currently provided in the amendment for dealing with unforeseen outlays associated with imminent threats to national security.

In providing for this exemption, the Council is evenly divided between option 1 and option 2.

Option 1 _____ Option 2 _____ Option 3 _____

IV. Asymmetry Between Increasing Taxes and Permitting Deficits

S.J. Res. 58, as currently drafted, makes tax increases more likely than spending cuts for balancing the budget over time. Increasing planned tax receipts in excess of the national income growth rate would require an ordinary majority of the whole membership in each House. Once tax receipts were increased, the base for calculating allowable tax receipts for future years would increase as well. This would provide a powerful incentive for those desiring higher future levels of spending to support increased taxes.

Allowing outlays to exceed receipts, with the resulting deficit, however, would require three-fifths of the full member-

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ship of each House. When a deficit is permitted in one year, the base for calculating allowable receipts in subsequent years remains unchanged and outlays in the future are not affected.

Thus, the asymmetry between the percentages required for enacting tax increases and allowing deficits would probably result in higher spending, in the long-run, than if both tax increases and deficits required the same percentage in each House.

The primary alternative for rectifying this asymmetry is to require 60 percent of the whole membership of each House for increasing taxes as well as for permitting a deficit. The administration faces two basic options with regard to the voting rules for deficits and tax increases:

Option 1: Require 60 percent of the whole membership of each House for increasing taxes as well as for permitting a deficit.

Advantages:

- o Restoring symmetry between the voting rules for allowing deficits and enacting tax increases would probably result in both lower spending and lower taxes in the long-run.
- o A proposal to require a 60 percent vote for tax increases would signal that the President's endorsing a balanced budget amendment did not contradict his belief that balancing the budget should result in lower spending, not higher taxes.

Option 2: Leave the voting rules for increasing taxes and permitting deficits in S.J. Res. 58 unchanged.

Advantages:

- o Allowing a simple majority for tax increases would prevent a 41 percent congressional minority from forcing the government into both fiscal and constitutional crises. Requiring 60 percent for both deficits and tax increases might make the amendment more difficult to enforce, and might result in higher total spending by providing special interest coalitions with increased bargaining power.
- o The current language of S.J. Res. 58 reflects negotiations and compromises between different elements of balanced budget and tax limitation movements. Proposed

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changes in the amendment by the administration might unravel this compromise, reducing the changes that the amendment will pass both Houses of Congress and the 38 state legislatures needed for ratification.

Recommendation: A large majority of Cabinet Council members support leaving the voting rules for increasing taxes and permitting deficits in S.J. Res. 58 unchanged. (Option 2)

Approve _____ Disapprove _____

V. Implementation Tools

A balanced budget requirement would increase pressure for indirect federal spending through novel budget devices outside the scope of any settled definition of outlays. While S.J. Res. 58 covers some conventional off-budget outlays, it would not cover federal loan guarantees and schemes to mandate fiscal outlays by private sector entities.

A balanced budget amendment might also result in Congress expanding appropriated entitlement programs. Under these programs, which include food stamps and unemployment compensation, the Congress can appropriate a relatively small amount at the beginning of a fiscal year, without reducing benefit eligibility with the almost certain knowledge that a supplemental appropriation will prove necessary before the fiscal year has ended.

Establishing both off- and on-budget control measures can occur through both constitutional and statutory measures. The most obvious constitutional measure is to provide the President with line item veto power.

A. Constitutional Implementation Measure -- Line Item Veto

The value of a balanced budget-tax limitation amendment depends in the end on the capacity to enforce it. Providing the President with line item veto enforcement power would require changing the Constitution. The arguments for and against the administration supporting a line item veto as part of a balanced budget amendment are straightforward.

Option 1: Support including a line item veto as part of a balanced budget constitutional amendment. But do not make support for S.J. Res. 58 contingent on a line item veto being included as part of the amendment.

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Advantages:

- o Providing the President with line item veto authority would more clearly focus responsibility for the rate of growth of federal spending.
- o There is ample precedent and widespread acceptance of the line item veto approach to controlling spending at the state level. Presently, 43 state governors have line item veto powers.

Option 2: Endorse S.J. Res. 58 without supporting a line item veto.

Advantages:

- o Line item veto power could result in Congress shifting more and more programs from appropriated accounts to entitlement status, since entitlements do not require annual legislation, and therefore are "veto-proof." A shift from appropriated to entitlement programs could only serve to further reduce the controllability of federal budget outlays.
- o Some would view an administration proposal to include the line item veto as an attempt to shift power from the legislative to the executive branch. Negative congressional reaction might diminish the prospects for enacting a balanced budget amendment altogether.

Recommendation: The Cabinet Council unanimously recommends supporting option 1. 0

Approve _____ Disapprove _____

B. Statutory Implementation Measures

Establishing outlay control measures can occur through statutory as well as constitutional changes.

The President could facilitate the development of statutory implementation measures by recommending that, following passage of an amendment by the Congress and referral to the states for ratification, the President and the Congress establish a bipartisan Budget Concepts Commission to consider statutory measures for ensuring that the amendment's objectives are achieved.

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The Commission would make its report after the amendment was ratified by three-fourths of the state legislatures. Its mandate would include recommending legislation to ensure that the amendment is not circumvented through off-budget techniques, spending devices which make overruns inevitable, or mandating that non-Federal Government entities perform certain functions.

Recommendation: The Cabinet Council unanimously recommends that you support establishing a bipartisan Budget Concepts Commission to consider statutory measures for ensuring that the amendment's objectives are achieved.

Approve _____ Disapprove _____